12/9/80 B 4750-1 U

Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research & Planning Division

Friday
(Noon)

Dec. 5, 1980

Thursday night, the Federal Reserve dispelled any lingering hopes market participants had that the Federal funds rate might begin to ease off during the week. The Fed's basic discount rate was raised to 13% from 12%, and the surcharge applied to large, frequent borrowers was lifted to 3% from 2%. Altogether, then, many larger banks face an effective discount rate of 16%, up from 14% previously. The impact of the move on short-term markets was profound and immediate, as the funds rate rose by a roughly similar amount to about 20% on Friday morning. The long-term markets, supported by widespread expectations that a peak in rates was near, were little affected. Against the background of an extremely tense international situation, the tone of the markets could aptly be described as panicky.

In the three months ended in October, large weekly reporting banks increased their business loans by almost $8 billion, while nonfinancial commercial paper contracted by almost $3 billion. More recent scattered data suggest that the trend has continued. The rapid fall-off of bond offerings has forced some would-be issuers to tap banks for interim sources of finance. Also contributing to the pattern has been the reduction in the spread of bank lending rates over the commercial paper rate.

Another source of the disparity in growth is the likely concern of some less highly rated paper issuers over their ability to continue to roll over their offerings. Fortunately, the present situation is fundamentally different from the Penn Central crisis of 1970, when the paper market contracted violently. First, there has been no such default this time. Second, much of the earlier panic reflected fears that, due to the banks' inability to issue CDs (Regulation Q ceilings were well below market rates), they might not be able to make good on credit lines backing the paper of issuers unable to roll over their outstandings. Fortunately, since Regulation Q ceilings are no longer applied to CDs, no such crisis of confidence is in store this time, however panicky the market may seem.

The most immediate consequence of this development is that some investors are replacing the commercial paper in their portfolios with CDs issued by banks to fund the increase of business loans. Since large CDs are not included in the narrow money stock, M-1B, that aggregate is not directly affected. However, to the extent that the business loans are accompanied by higher levels of compensating balances, M-1B would be raised, but only by a small amount relative to the recent surge in the money stock.

William C. Melton

Note: The full text of this letter is available to Telerate Subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	12/5/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(Noon)		
Short-term loans to substantial depositors			
with highest credit rating	19.00%	17.75%	15.25%
Effective since	12/5/80		
Discount Rate at Federal Reserve Bank	13.00	12.00	12.00
Federal Funds	20-25	18.50	13.63
Repurchase Agreements	19.75	16.00	12.50
U.S. Treasury Issues			
Bills			
3 months	16.57	14.85	12.30
6 months	16.22	15.25	12.50
1 year	14.71	14.85	11.90
Coupons			
2 years	14.39	13.97	11.18
4 years	13.65	13.24	10.35
7 years	13.15	12.85	10.30
10 years	12.93	12.62	10.24
Long Bond	12.44	12.24	10.00
Negotiable Certificates of Deposit-Secondary Market			
1 month	18.50	17.15	13.00
3 months	18.45	17.10	13.10
6 months	17.15	16.25	13.10
1 year	15.00	14.25	12.45
Banker's Acceptances			
1 month	18.50	17.10	13.05
3 months	18.50	16.90	12.85
6 months	17.15	15.35	13.10
Eurodollar Deposits			
1 month	19.50	18.25	13.75
2 months	19.50	18.13	13.88
3 months	19.00	18.00	14.00
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	17.00	15.00	13.00
1 month	16.25	15.00	13.00
3 months	14.25	14.25	11.50
Bank Holding Companies			
1 month	17.50	16.63	13.00
Dealer Placed:			
3 months	17.50	NA	13.00
New AA Corporate Utility Bond	14.50	14.38	11.50
Tax Exempt			
6 month Project Notes	8.00	8.25	6.15
1 year AAA Bond	7.50	7.00	NA
5 year AAA Bond	8.25	7.40	NA
20 year AAA Bond	9.85	9.00	6.70

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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